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AZ CORP COMMISSION
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IN THE MATTER OF THE APPLICATION OF OF VAIL WATER COMPANY FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANT AND PROPERTY AND FOR AN INCREASE IN ITS RATES AND CHARGES BASED THEREON.	DOCKET NO. W-01651B-12-0339 **STAFF'S NOTICE OF FILING TESTIMONY IN SUPPORT OF SETTLEMENT AGREEMENT**

Staff of the Arizona Corporation Commission ("Staff") hereby files the Testimony of L. John LeSueur in Support of the Settlement Agreement in the above docket.

RESPECTFULLY SUBMITTED this 3rd day of May 2013.

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Arizona Corporation Commission
DOCKETED
MAY 3 2013
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Original and thirteen (13) copies of the foregoing filed this 3rd day of May 2013 with:

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Copy of the foregoing mailed this
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BEFORE THE ARIZONA CORPORATION COMMISSION

BOB STUMP
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Commissioner
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Commissioner
BOB BURNS
Commissioner
SUSAN BITTER SMITH
Commissioner

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TESTIMONY

IN SUPPORT OF

THE SETTLEMENT AGREEMENT

L. JOHN LESUEUR

ASSISTANT DIRECTOR

UTILITIES DIVISION

ARIZONA CORPORATION COMMISSION

MAY 3, 2013

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EXECUTIVE SUMMARY
VAIL WATER COMPANY
DOCKET NO. W-01651B-12-0339

Mr. LeSueur's testimony supports the adoption of the Settlement Agreement ("Agreement") proposed by the parties in this case. Mr. LeSueur's testimony describes the settlement process as transparent and productive, and explains why Staff believes the adoption of the Agreement is in the public interest.

I. INTRODUCTION

Q. Please state your name, occupation, and business address.

A. My name is John LeSueur. I am employed by the Arizona Corporation Commission ("Commission") as an Assistant Director in the Utilities Division ("Staff"). My business address is 1200 West Washington Street, Phoenix, Arizona 85007.

Q. Please state your educational background.

A. I graduated from the University of Texas School of Law in 2003 with a Juris Doctorate and from Brigham Young University in 2000 with a Bachelor's Degree in Economics.

Q. Please describe your professional work experience.

A. I am a member of the Arizona State Bar. From September 2003 through November 2006, I worked as an environment and natural resources attorney for Fennemore Craig. I worked on cases involving the Federal Clean Water Act, the Federal Safe Drinking Water Act, and Arizona's Underground Storage Tank Assurance Fund.

From January 2007 thru December 2012, I was employed by the Commission as a policy advisor for Commissioner Gary Pierce. As policy advisor, I advised Commissioner Pierce on all cases and legal matters pending before the Commission.

In January 2013, I began working in my current capacity as Assistant Division Director for the Utilities Division. In my current role, I review submissions that are assigned to the Utilities Division, make policy recommendations to the Director, and supervise Staff's preparation of testimony and Staff Reports that are submitted for the Commission's consideration.

Q. What is the purpose of your testimony in this case?

A. My purpose is to explain why Staff supports the adoption of the proposed settlement agreement ("Agreement"). My testimony will address the settlement process, provide an overview of the Agreement's provisions, and discuss public interest considerations.

Q. Did you participate in the settlement discussions that resulted in the Agreement?

A. Yes, I did.

Q. How is your testimony organized?

A. My testimony has four sections. Section I is this introduction, Section II discusses the settlement process, Section III provides an overview of the Agreement, and Section IV presents Staff's view of the public interest supporting the adoption of the Agreement.

II. SETTLEMENT PROCESS

Q. Please describe the settlement process.

A. On June 27, 2012, Vail Water Company ("Vail" or "Company") filed an application for a rate increase with the Commission. The only two parties in this case are Staff and the Company; no other parties have applied for intervention. Shortly after the Company filed its rebuttal testimony on March 25, 2013, the Company expressed interest in initiating settlement discussions as a potential means for resolving the outstanding disputed issues. On April 10, 2013, Staff docketed notice that the parties may enter into settlement discussions as early as April 16, 2013. Staff met with representatives of the Company on April 16, 2013, and began the discussions that culminated in the Agreement.

Q. How would you characterize the process?

A. I would describe the process as transparent and productive.

III. AGREEMENT

Q. Please describe Sections 1, 7 and 8 of the Agreement.

A. These are boilerplate provisions that Staff routinely includes in the settlement agreements it enters into. Section 1 contains the recitals of the Agreement and establishes the predicate circumstances. Section 7 sets forth the procedure for the Commission's eventual adoption, modification or rejection of the Agreement, as well as the parties' rights and responsibilities therefrom. Section 8 contains standard miscellaneous provisions.

Q. Please describe Section 2 of the Agreement.

A. I view this Section as the backbone of the Agreement. It sets forth the Company's test year revenue, along with the revenue increase it needs to meet its revenue requirement. It also establishes the Company's fair value rate base at $3,315,108. One of the key issues resolved by the parties during the settlement discussions was the appropriate treatment of the Central Arizona Project ("CAP") recharge credits that the Company accumulated since its last rate case. The Agreement treats those credits as a component of rate base because the Company acquired them with Company revenues, not customer contributions, and because the credits are used and useful in the provision of service to its customers.

Q. Were the Company's existing CAP recharge credits funded, at least in part, via the Company's CAP Hook-up Fee?

A. Yes, they were.

Q. Is it not Staff's usual recommendation with respect to assets acquired via hook-up fees to exclude them from rate base?

A. It is. The reason Staff has agreed to different treatment in this case is because the Commission specifically ordered that the CAP hook-up fees be treated as revenues in the Company's last rate case (Decision No. 62450). In the last case, Staff recommended that the Company's CAP hook-up fees be treated as a deferred credit, but the Commission ordered that they be treated as revenue. Because the Company funded the CAP recharge credits with revenue, and not customer contributions, Staff believes it is appropriate to include the CAP recharge credits in the calculation of rate base in this case.

Q. But even if the CAP recharge credits are rate base eligible, are they currently used and useful?

A. That is an interesting question because it raises the issue of who should pay for the transition of the Company from depletable to renewable water supplies. Who benefits from the long-term sustainability of the aquifer, current or future customers? Staff concludes the answer is both. In fact, even if there were no growth in the Vail service area, the Company would still need to use CAP water to comply with the State's policy of reducing the use of groundwater. In order to avoid the potential for discouraging the Company from making reasonable and prudent expenditures in transitioning towards a renewable water supply, Staff concludes it is appropriate for the Commission to view the Company's existing CAP recharge credits as used and useful so the Company can continue to timely recover the expenses associated with acquiring those credits.

Q. With respect to the agreed upon fair value rate base of $3,315,108, has Staff changed its recommendation on the excess capacity issue identified in Marlin Scott's Direct Testimony?

A. Yes, after reviewing the Rebuttal Testimony of Kara D. Festa, Staff now understands why Well #6 is needed for the system operation and demand. Her additional information provided clarifications related to, 1) updated well flow data, 2) Well #3's production can only serve the south service area and not the north service area, 3) Well #5's operation also addresses a low pressure area, and 4) all the north service area wells (#5, #6 and #8) are needed to provide the high construction water use. Staff concurs with the Company that Well #6 is not excess capacity but instead is used and useful in this rate proceeding.

Q. Has Staff also changed its recommendation on the plant retirement issue identified in Marlin Scott's Direct Testimony?

A. Yes, after reviewing the Rebuttal Testimony of Thomas J. Bourassa and his clarification of the Company's response to Staff's Data Request MSJ 4.1, Staff concurs with the Company that plant retirements should be shown at $92,956.

Q. Please describe Section 3.

A. Section 3 proposes a 9.1 percent cost of equity for the Company, based on a 100 percent common equity capital structure. To place that number in perspective, it is 90 basis points below the cost of equity Staff is recommending for Arizona Water (which essentially has a 50 percent debt / 50 percent equity capital structure) in a settlement agreement Staff has signed in Docket No. W-01445A-12-0348. It is also 145 basis points below the cost of equity the Commission recently recognized for Arizona Water in Decision No. 73736.

Staff concludes that a reason it is appropriate to award Vail a lower cost of equity than Arizona Water is due to Vail's 100 percent equity capital structure. However, Staff recognizes that a 9.1 percent cost of equity may not have been achievable outside of a settlement agreement. Under the circumstances, Staff concludes that the 9.1 percent cost of equity is a significant ratepayer benefit of this Agreement.

Q. Please describe Section 4.

A. I would describe this as the second most important Section of the Agreement. The parties agree that the Company should recover the costs it incurs in transitioning from a depletable to a renewable water supply via a CAP Surcharge. Since 2000, Vail has been recharging its CAP allocation in Marana near the CAP canal at a recharge facility operated by Kai Farms. The recharge facility is over 30 miles from Vail's service area. By the end of 2015, Vail intends to begin direct use of its CAP allocation within its service territory. It is negotiating a wheeling agreement with the City of Tucson, and submitted for Commission review on April 18, 2013, final plans for the direct use of CAP water within its service territory.

Staff concludes that these efforts are in the public interest. As I stated earlier, Staff concludes that the Company's existing and future ratepayers are benefiting from the Company's efforts to bring renewable CAP water into its service territory.

Staff recognizes that delivering CAP water into the Company's service territory is not easy, nor is it free. Accordingly, Staff supports the Agreement's proposal to create a CAP Surcharge. The purpose of the CAP Surcharge would be to allow the Company to timely and transparently recover its CAP water and delivery costs from its customers.

As described in the Proposed Plan of Administration for the CAP Surcharge, which will be filed prior to the May 7, 2013 hearing, the CAP Surcharge will include the following components:

- Component 1 - Variance from Combined CAP Municipal and Industrial ("M&I") Capital and CAP Delivery Charges included in Base Rates – This component is based upon variances between the combined CAP M&I capital and CAP delivery charges in effect for the applicable year and the combined rates ($105.87 per acre-foot) included in base rates.

- Component 2 - Tucson Water Wheeling Fees – This component is based upon the fees set forth in the final Wheeling Agreement between Vail and Tucson Water and the volume of water delivered to Vail's service territory as defined by the Wheeling Agreement.

- Component 3 – Periodic Unrecovered Recharge Credits – This component applies the rate variance calculated in Component 1 to any excess of the total CAP allocation (in acre-feet) and the total water wheeled to customers. It is an asset that represents the CAP costs included in long term storage credits reserved for future use.

- Component 4 – Prior Year Under/(Over) Recovery – This component represents the over/under recovery of the prior year's costs through the surcharge.

- Component 5 - Long Term Storage Credit Recovery – This component reflects the value of Long Term Storage Credits to be recovered from ratepayers and used to offset CAGRD fees. The amount for recovery from ratepayers is calculated using average inventory cost. Vail will provide documentation to support these amounts.

- Component 6 - Gain on Sale of Long Term Storage Credits – This component reflects the customers' share (50 percent) of any profit resulting from the sale of Long Term Storage Credits to third parties.

- Component 7 - Excess Water Loss Disallowance – This component is a disallowance of CAP M&I capital and CAP delivery charges based on unaccounted for water loss in Vail's system in excess of 10 percent. If Vail's water loss for the 12 months prior to the date of filing for a new surcharge exceeds 10 percent, the total amounts of the other components will be reduced by the percentage that water loss is in excess of 10 percent.

Q. Please describe Section 5.

A. Section 5 states that the Company agrees to Staff's proposed rate design, which is Staff's typical rate design that it routinely proposes in water utility rate cases pending before the Commission. Staff's proposed rates are designed to recover almost 37 percent of revenue from the monthly minimum, and just over 63 percent of revenue from the commodity rate.

Q. Please describe Section 6.

A. The Company retains management services from TEM Corp. This Section requires the Company to obtain time sheets from TEM Corp. to support the management fees requested for recovery in future rate cases. Staff concludes that this sufficiently resolves all issues raised in this case regarding management expenses.

The Section also proposes that the Company's CAP Hook Up Fee Tariff be eliminated as CAP water and delivery costs will be recovered, as I discussed above, in the base rate and via the CAP Surcharge.

Q. Are there any outstanding issues in this case not addressed by the Agreement?

A. The parties intended the Agreement to be a global settlement of the issues raised in this case. During the pre-hearing conference on May 2, 2013, however, the Administrative Law Judge asked whether the Company had agreed to Staff's recommendation that it adopt at least five Best Management Practices ("BMPs") in the form of tariffs that substantially conform to the templates created by Staff for Commission review and consideration. Although it is not explicitly stated in the Agreement, Staff has confirmed that the Company will accept Staff's recommendation.

IV. PUBLIC INTEREST

Q. Please explain why Staff believes adoption of the Agreement is in the public interest.

A. Staff believes adoption of the Agreement is in the public interest for the following reasons:

1. The Agreement contains a 9.1 percent cost of equity, which Staff believes is balanced in favor of minimizing rates for ratepayers;
2. The Agreement fairly resolves a potentially litigious issue concerning the treatment of the Company's existing CAP recharge credits; and
3. The Agreement provides for timely and transparent recovery of the costs incurred in bringing renewable CAP water into the Company's service territory and thereby reducing Vail's reliance on groundwater.

Q. Does this conclude your testimony?

A. Yes.